



State of Oregon

Legislative Revenue Office

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Research Report

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Interstate Broadcaster Apportionment

Pursuant to 2014 HB 4138

In 2014 the Legislature passed, and the Governor signed into law, HB 4138. The bill modified how corporation income for interstate broadcasters is apportioned to Oregon. Put simply, it changed the apportionment percentage from one based on the share of viewers in Oregon (i.e. audience factor) to the state of domicile for the direct customers of the broadcasters (i.e. domicile factor). The policy change was a temporary provision, affecting tax years 2014 through 2016, and required a report by the Legislative Revenue Office evaluating the impact of the change. This report meets that statutory requirement and is expected to facilitate the legislative policy review during the 2017 session.

I. Prior Law

Prior to tax year 2014, interstate broadcasters that had nexus in Oregon apportioned their income according to the share of their company's U.S. audience that was in Oregon. Calculation details are contained in Oregon Administrative Rules. For television, the audience factor was determined by the rating statistics from sources such as Arbitron and Nielsen, or by the average circulation statistics published in the Television and Cable Factbook. For radio, the audience factor was determined by the rating statistics from sources such as Arbitron or Birch/Scarborough Research. Cable television relied on the ratio of Oregon subscribers to U.S. subscribers. Under certain circumstances, an alternate approach could be used - the ratio of the company's broadcast area population within Oregon compared to their broadcast area population in all states. In any event, the source chosen was to be used consistently over time.

II. Tax years 2014-2016

In discussions started during the 2013 legislative session and culminating with HB 4138 in 2014, industry advocates argued that a more appropriate apportionment method would be based on the location of their direct customers. They argued that this approach is more consistent with Oregon's policy of single sales factor apportionment. This policy effectively states that the share of a corporation's income to be taxed by Oregon is best measured by the company's share of U.S. sales made in Oregon.

The industry describes their customers as falling into one of three groups: (1) distributors; (2) advertisers; and (3) direct consumers. The first group, distributors, are entities that buy television and radio shows for a viewing or listening audience. Examples include cable operators, satellite operators, and internet distributors. Advertisers are entities that purchase time during television and radio shows to sell their products to viewers and listeners. The third group is the smallest, yet rapidly growing type, of customer. This group represents viewers who purchase content directly,

usually through a monthly or annual subscription. Examples include HBO Now, Amazon, Netflix, and Hulu. This category is sometimes referred to as “over-the-top” content.

The location of each type of customer is determined by their state of domicile. Generally, this means the location of headquarters for distributors and advertisers, and state of residence for households that are direct consumers. Ultimately, the Legislature chose to adopt the domicile apportionment method on a three-year basis and then evaluate the policy to determine subsequent action. Based on information provided by the Motion Picture Association of America (MPAA) during the 2014 legislative session, the Revenue Impact Statement for HB 4138 indicates an estimated revenue gain of \$0.9 million for tax year 2014, to be collected during the 2013-15 biennium.

III. Policy Analysis

To track initial use of this apportionment method, the Department of Revenue (DOR) included a check-box on the tax return for corporations to indicate that they were a broadcaster using the domicile method of apportionment. A total of 17 corporations checked the box for tax year 2014. Upon review of those returns, most of them appeared to have been checked in error. In an effort to get better data, the DOR sent a letter to 26 corporations thought to be broadcasters and requested additional information. Of the 26 corporations contacted by the DOR, nine corporations responded with additional information, two indicated they were not broadcasters, and 15 did not respond. Of the nine that provided information, some respondents were able to provide information for tax year 2015 as well as tax year 2014. In all, there are eleven data points (the combination of a taxpayer and a tax year) available for analysis.

The primary data of interest reflect the change in the amount of Oregon sales included in the numerator of the apportionment percentage. The denominator, which is U.S. sales, would not change. Industry had argued that, in general, the amount of Oregon sales reported in the numerator would increase under the domicile approach. For a given amount of federal taxable income, an increase in the numerator (i.e. Oregon sales) would increase the apportionment percentage. This increase would lead to larger Oregon taxable income which, in turn, would lead to a larger tax liability. Industry expected an increase in tax liability to be worth the policy of apportioning income based on the domicile of their customers.

Analysis of the available data revealed that nexus was a key issue. As background, calculating Oregon corporation income tax liability is, in part, a two-step process. First, if a corporation has nexus in Oregon, then it is subject to the corporation income tax. Second, if nexus is established, the question moves to how the corporation’s federal taxable income should be apportioned to Oregon. Roughly half of the broadcasters that provided data indicated that they did not have nexus in Oregon (for broadcasting activities), so such activity would result in zero Oregon sales. For the other half, it was unclear if they held that same position.

Based on conversations with industry representatives and the DOR, it became clear that there may not be a uniform opinion regarding nexus. It appears that some companies hold the position that they do not have nexus in Oregon, but agreed to set that issue aside while the domicile method of apportionment is used.

As an illustration, the MPAA provided apportionment data for six companies. Under the audience provision, the average apportionment percentage was 0.07% (including sales from activities other

than broadcasting). Using the domicile provision, that figure increased to 0.17%, leading to an increase in Oregon tax that was consistent with the projected impact from HB 4138. On the other hand, use of the audience provision under alternate nexus assumptions results in an apportionment percentage that may be closer to 1.2%, Oregon's share of the U.S. population. However, the actual figure could vary a great deal depending on the demographics of a given broadcast.

A complicating factor for understanding the impact of this apportionment policy is the fact that two companies are in a legal dispute with the DOR about the definition of an interstate broadcaster and its tax implications. Comcast disputes an audit relating to tax years 2007-2009 and NBC Universal disputes an audit relating to tax years 2011-2013. In part, the companies are arguing that they are not interstate broadcasters and should not have all their income (as opposed to just broadcast income) subject to the broadcaster apportionment provisions. The DOR is arguing that they are broadcasters and that statute requires them to apportion all their income accordingly. The Oregon Tax Court has ruled in favor of the DOR against Comcast; the case is currently under appeal. The other case is currently in the Magistrate Division of the Tax Court and may not be heard until the results of the other dispute are known.

Determining the impact of this policy choice (i.e. domicile vs audience) is significantly hindered by three layers of uncertainty: (1) lack of clarity regarding who is a broadcaster; (2) broadcaster nexus; and (3) which revenues are subject to apportionment under the broadcaster statutes. Regarding the first uncertainty, the current landscape makes it unclear as to the full breadth of who might be affected by the policy, which presents obvious challenges. Then, even if there were agreement on the full list of broadcasters, there is uncertainty regarding nexus, as described above. The two pending court cases highlight the third layer of uncertainty - which sources of income are subject to the broadcaster apportionment. Even if a given company is an interstate broadcaster with nexus, the question remains as to whether all the corporation's income or just its broadcasting income is subject to the broadcaster apportionment statutes.

IV. Conclusions

Despite the lack of clarity surrounding the policy impact, the Legislature has options regarding the existing policy sunset date. The Legislature could allow the policy to sunset, extend the policy for a fixed number of years, or eliminate the sunset. The Legislature can also explore policy options related to the questions being considered by the court. Any policy decisions could be implemented prior to a final court ruling or be prepared as a response to an eventual ruling.